PANEL TWO

JUDGE BONAPFEL: If ya'll want to take your seats, we'll get started on the next part of the program. In this segment, we're going to talk about developments in Chapter 11 litigation and practice, and we have two outstanding attorneys from Atlanta here to help us do that. First of all from the law firm of Troutman & Sanders LLP is Harris Winsberg who has the bad fortune to have graduated from the University of Florida, both undergraduate and law school.

HARRIS WINSBERG: That's right, Judge, Double Gator.

JUDGE BONAPFEL: A Double Gator, which, for those of us who are of the Seminole persuasion, is a—and Georgia Law School, is doubly distressing. But notwithstanding that, he's somehow been able to overcome those obstacles and works with Troutman Sanders in their bankruptcy law and corporate restructuring practices and does a significant amount of litigation, including, in the bankruptcy area, preference and fraudulent transfer litigations. So, we're happy to have Harris here with us this morning.

Also here is John C. (Kit) Weitnauer with Alston & Bird. He works in their bankruptcy group among others. Kit's most recent accomplishment is he served as counsel to the plaintiffs in a five-week jury trial in Oregon that resulted in a jury verdict that found over $1 billion (that's a lot of zeros) in transfers to have been made with the actual intent to hinder, delay, or defraud plaintiffs, and also got $350 million in punitive damages. I hope you had it on a contingency and I hope you collected.

KIT WEITNAUER: Well, we collected it, but regrettably it wasn't a contingency.

JUDGE BONAPFEL: Oops. This jury verdict was ranked number 1 in *The National Law Journal's Top 100 Verdicts of 2006*. Kit has been featured in the Best Lawyers in America since 1995. He is a contributing editor of two bankruptcy treatises, *Norton Bankruptcy Law and Practice* and the *Bankruptcy Litigation Manual*, as well as the ABI Journal, and he is co-author of the book *Problem Loan Strategies*.

So, thank you both for being here. We're going to focus on four specific topics this morning. One is the valuation of a business in bankruptcy cases and adversary proceedings and the use of expert witnesses to provide evidence of that. Second is spoliation of evidence problem. Something that I, quite frankly, never heard of when I started practicing but is becoming an important litigation issue and poses special problems in the context of a bankruptcy case, where everything is potentially subject to litigation. Third, we're going to talk about the duties of a committee of unsecured creditors to provide access to information and to solicit and receive comments from its constituents and the use of committee protocols to do that. And, then, finally, issues relating to lawsuits arising out of fraud or other improper conduct on the part of management against pre-petition professionals in an effort to find deep pockets to fund recoveries for creditors.

So, we're going to start with litigating the valuation—the value of a business. Valuation, of course, is a central issue in many bankruptcy cases and adversary proceedings. For example, in a preference or fraudulent transfer case, one of the elements of the plaintiff's case is the insolvency of the debtor at the time of the challenged transfer. In a fraudulent transfer action where the transferred asset was a business and this typically involves a situation where the fraudulent transfer action challenges a leveraged buyout transaction. The business itself must be valued. In other words, it's not just a simple add up all of the assets and add up all of the liabilities and see where you are. It's the value of the business. Similarly, confirmation of a Chapter 11 plan may require a valuation of the business for cram-down purposes. A recent example of that is the Mirant case out in Texas. When the valuation of a business is an issue, it is not just a question of adding up the values of assets and debt. The value of the business must be determined, and expert witnesses are needed to provide evidence of this fact.

In this segment, we're going to explore three aspects of this valuation process: 1. The selection and preparation of expert witnesses in light of the Supreme Court's Daubert decision that governs admissibility of expert testimony in federal courts; 2. The valuation methods an expert uses in valuing a business; and 3. Issues that arise when the business to be valued is a public company with a market for shares.

Kit, what do I need to know about the selection and preparation of an expert on valuation and, refresh my recollection, because I think Daubert was decided after I graduated from law school? So tell me what it is.

KIT WEITNAUER: Yeah; actually a lot of cases have been decided since that day, Judge. We're really hoping that you read some of them, but let's talk about Daubert. It's a very interesting area and a complicated area; one that means you got to do a lot of thinking ahead of time about your experts and the other side's experts. But pre-Daubert, the rule for expert testimony was the theory, the scientific principle generally accepted, and the courts didn't give a lot of guidance with that test and many decisions and many commentators criticized that test as allowing what was dismissibly referred to as "junk science" as coming into the court room. In 1993, the Supreme Court in the Daubert case took a stand on that. It was a case involving scientific expert testimony. And the court set out some more guidelines on what the role of the judge is in assessing and letting in or excluding expert testimony. And the inquiries were things like this: Is that testimony reliable and relevant? The judge is supposed to serve as a gatekeeper before the testimony gets to the jury. And how do you find out if the testimony is reliable and relevant? Well, has the theory been tested? Has the theory been peer reviewed? What is the rate of error for the theories applied to various facts? What sort of support is there in the relevant scientific community for this theory or by contrast lack of support? The focus is supposed to be on the principles of the theory and the methodology of the theory, not the conclusions of the theory. And the court, despite all these various ways of looking at and testing scientific expert testimony, did affirm the role of vigorous cross-examinations. When it came to shake, but otherwise reliable scientific evidence, which seems like a contradiction in terms, but nevertheless it shows that you don't have to have a complete certainty about evidence before it comes under this nature.

And then in 1999, a case called Kumho Tire, also from the Supreme Court, made clear what folks had wondered and some courts have said must be the case that this gatekeeper role applies to all expert testimony. It expands to technical and other specialized knowledge as well, not just the scientific. The federal rules of evidence were admitted in 2000 to take into account the guidance from the Supreme Court, so always be sure to flip over to Rule 702, 703 that embodies some of this teaching. And you also have to keep in mind, Federal Rule Supp. 26, which talks about your expert report. A couple of things there: One is in federal practice you're going to have an expert write a written report containing his conclusions, all the data or information considered by the expert in coming up with the conclusions. In Rule 26A4 talks about your right to depose testifying expert and the severe limitations on when and if you might be able to testify, excuse me, depose a consulting expert. Now, these last two rules I didn't think about in Oregon law, because

in Oregon the only time you learn about expert testimony is when the judge looks down at the other side and says, "Call your next expert—next witness." Say I call on Dr. Bonapfel and he takes the stand, and there you go. That's how it works. It's trial by ambush there. But nearly everywhere else you're going to have a chance to get into the details of the expert's testimony, and the other side, of course, will get a chance to get into the details of your expert, which is a good thing. I'm against trial-by-ambush as much fun as it is.

So, how do you select an expert? Well, first off, they have to be qualified. That's sort of the first thing I think you get out of these rules and these decisions. And experience alone can suffice. If we're talking about commercial valuations or valuations of businesses, you don't have to have a degree in valuation. I'm not sure there are degrees in valuation, but there may be somewhere. But you don't have to have that. Experience will suffice. I think it always helps to have an expert who's published in the field. And there are organizations that give certifications, and post-graduate training about this sort of stuff, and I think that can be helpful too for the expert's resume. One thing you don't want is an expert who says something like this at his deposition or trial, "I have no formal education or training in valuing businesses. I have no experience in valuing businesses. And I'm not certified and I don't issue valuation reports," and the case is one where you're having a valuation. Now, you might think I was making that up, but that is actual deposition or trial testimony from a case that's on Page 4 of my materials. And, you know, it blows my mind that anybody would go into court thinking that someone like that would do them any good. So, you know, stick to the basics. Make sure you got somebody who's got the kind of qualifications for the sort of case you got. And on a side note I would say, and the cases in my material talk about this, you don't have to have someone who's so narrowly focused. You might have some oddball asset that's being evaluated. It doesn't have to be someone who can only do that sort of thing. You can have folks who have a broader range of ability in valuation who can bring the tools of valuation to that particular asset. I think it's helpful if you have a choice between folks who are otherwise equally qualified, the person with the great breadth of experience and the like and training is going to be better, because facts change in cases and, you know, your theories, your data, your focus can change and you hate to have someone so rifle-shot focused on what you thought the problem was on day one of the case and that shifts a little bit later and then, oh gosh, you need somebody else.

Your expert can't be biased. That's really the second thing relating to the qualification and selection of the expert. And I think that gives you a couple of simple rules. One is no prior connection to the case. There's a case I cite in my materials where the court basically said if there was a prior connection, there's no way the expert can be qualified. They either take into account what they knew from their prior connection. Ooh, that's bad. Or they try to ignore it, and they say why you trying to ignore it if it's relevant? It seems like a "you can't win" sort of situation. You can't have a contingency fee. In one case I found, they actually had that. They disguised it. And despite that, the court did not throw everybody in jail. But it was clear that that was a big factor in discounting the testimony and wanting to not really give it any weight. And another point on bias that, you know, think would normally come under cross examination but could be sufficiently bad to get your expert disqualified under Daubert is the expert always exercising his or her judgment on the side of the party that hired them. And there's a good case cited in the materials where every time the expert had to weigh things, the thumb always went down on his client side. Every time a judgment had to be made, yeah I see it this way. I see it this way. And that pushed the valuation very strongly in one direction. And the court found that this constant decision of everything breaking in that direction showed bias. And so that's something to keep in mind.

Now, once you have somebody's who qualified, the focus of most of the cases, because most people find people who are qualified, is lack of reliability. And what's important to keep in mind here is that some of the things you see in the Daubert decision don't always apply to testimony by valuation. For instance, lack of peer review or the concern that the opinion was developed just for the case. Well, you know, nobody goes out an academia and spends a whole lot of time valuing the business of Freightliner in Oregon building trucks, so all of us had to get experts for that in our case. But that's okay. In valuation, the world knows that experts don't do that the same way they might study disease and the causation of disease.

What about the fact that the valuation is based on some subjective judgment of the expert? Well, in science, you're probably just going to be looking at the test tube, right? Maybe that's just rigorously objective, but in valuation there's all sorts of spots along the way where the expert has to make judgments, and that comes from experience, and learning, and that is going to be okay, subjective to the bias problem I gave you a minute ago. That's going to be okay. And, in fact, the literature, the valuation literature, talks about the necessity of experts in this field making these kinds of judgment. So that's not

going to be a problem as long as you avoid the bias problem. Now, the next one is one that I think Judge Bonapfel wanted us to go over, which was the Accepted Valuation Methods, and this is important because failure to use an accepted valuation method can result in the court finding your expert lacks the requisite degree of reliability. So, in valuing a business, what are your typical ways of doing that?

There are three: one is the discounted cash flow method; one is comparable transactions, and the other is usually called a multiples approach. So you're taking a multiple of EBITDA or a multiple revenue using multiples from comparable companies. The one that is often thought of as being the goal of standard is discounted cash flow method. What is that? Well, you sit in your chair today or at the time of the valuation and you say what are the predicted future cash flows from this business, going out whether it's three years, five years, ten years, whatever the expert might think is appropriate, and then you discount that cash flow to its present value. And, boom, that's your number. That puts a lot of weight on your discount rate, and it puts a lot of weight on those future cash flows and all the assumptions that are used to make those cash flows and to predict those cash flows. And here I'm going to digress a bit to talk about the issue of hindsight, and I'll do it in the private company context. But the same issue comes up when you shift to valuation of a public company. The stock market has presumably thought about these future cash flows and has put a value on the company through the public markets and stock sales. Today, we're all sitting here trying to figure out from a business deal what the value of Company X was. All we can do is predict the future and discount it and, boom that's our estimate. And that would be true at a confirmation hearing. Because we're talking about future value or future events impacting our value today. If you're talking about a fraudulent transfer case or preference case, especially fraudulent transfer case with a long statute of limitations back in the past, you're talking about a value in the past. So here it is 2008, let's say our transfers occurred in 2005, so what does our expert do? Does our expert go back in time, back in the way back machine, and say if I had been sitting there in 2005, what projections would I have made about this company? And then having made those, I'll discount them; that's what I think the value is. And as part of that process does that expert say, "What projections were in the files in 2005 that the parties might have used at the time to think about valuation?" If those were reasonable, can I use those? And that's what I think most experts do, but if you look at the valuation literature, there's really not a lot of guidance that I could find, anyway, that was real clear on the fact that you've got to go back in the way back machine and do that, as

compared to this: suppose in 2005, we knew that everybody had rose-colored glasses on about this company; projections were fabulous, and then in 2006, things just went downhill. It was awful. Nothing turned out the way some of these projections said. Well, hindsight tells us that company wasn't worth near as much given what actually happened in the next few years between 2005 and today, when we're trying to make this judgment about a value back in 2005. Are we allowed to consider, are we allowed to use hindsight in coming up with that valuation?

Some of the cases are actually fairly mixed on this point. There's not that many of them. Most valuators tend to put themselves in the way back machine and say that hindsight is improper. But the cases are mixed on this point. And my view is that, there's probably no hard and fast rule about it, but I don't think it's right to exclude hindsight. Because you can imagine that if you had five appraisers back in 2005, all trying to predict the future, maybe one or two of them would have predicted that things would have turned bad in 2006, '07, and '08. And if you were then looking back today, and said, "Gee, we had five opinions back then, who we think did the best job? Gee, the person who actually predicted this down turn." I was talking about this in another seminar, and a judge, excuse me, a lawyer was there who said he was involved in a fairly lengthy confirmation hearing that got put off from time to time for reasons I don't recall, and at the first hearing there were projections, all future looking, and they were very varied. Well, they didn't finish the matter by then, so nine months later, a year-and-a-half later, they get back into the case again, which seems very odd, they're looking at the projections again, and history had proven that one valuator was more accurate than the other. And that kind of entered the inquiry for the court because human nature tells us that, "Gee, the person got it right." And so, human nature, I think, tells us that hindsight is something that is 20/20, as compared to going to the way back machine.

Now, I could see it going either way in a particular case, but I don't think there should be, per se, rule about excluding that hindsight that you can get from the benefit of time. But this kind of cash flow method, in any event, is considered so fundamental to what people do. In investment banks and the valuation world, is that if you have a valuator who doesn't use that one, there are cases that say throw that guy out. That guy is not even reliable. There's some controversy about that, too, but you really better have a good story if you're not using the discounted cash flow method. But these other methods are important, too. If nothing else, they provide a sanity check, a reality check of the numbers from other methods. And it's important, I think, for any

credible valuator to use at least three, and they better have a good reason to explain why they didn't use one—hey, that the data was bad, whatever—before they just don't do it, because all these can help triangulate on to a solid opinion. Um, stop me if I'm talking too long.

There's other points such as someone who uses a method that's not recognized in the industry. Well, that's going to get your guy thrown out. You can't use improper or inconsistent methods. So you can't use numbers in one method and then say, "Oh, they don't count for this method," when they should. You got to be careful about that. Your expert has to be sure that the expert is using reliable data. You can't just take any number that comes out of discovery. You got to be sure it's reliable. And you can't be using unreliable data or unverified data. So you wind up getting into very, very detailed look at what the expert has done.

Another problem that people get into from the Daubert standpoint is the expert has relied on evidence preselected by counsel. Well, that's another form of bias, really. So what we had to do in our case, and I recommend it for everybody as expensive as it is, you may have rooms and rooms of discovered responses, we brought our experts in and said, "Look, if it were us, we'd probably tell you that a lot of this is not relevant to what you're doing, but you guys are the experts, somebody's got to look at all of it." And somebody from the valuator's office looked at every page and, in fact, only a small portion was considered relevant, but that was their call, not mine. And they can get on the stand and say, "My people looked at everything. They brought me what I needed to look at," so forth, and so on.

Unreasonable assumptions: Valuators get knocked out when they say, "Well, I think inflation is going to be 0.1 percent for the next two years and prices ought to be able to go up for this company at 14 percent per year." You know, stuff like that just doesn't make any sense. You've got to test your model in some way, shape or form. You got to check the reasonableness of the results if you used the model, and if you don't you just open yourself up to trouble.

Experts can use the opinions of other experts. We had that problem in our case, and it's just something that is okay. You need to know that, be prepared for it too in your case. And experts can correct errors, especially when you got the federal system where you're going to have a chance to have a full cross examination of the report. Errors are going to come up. Experts ought to be free to correct. That's part of the reason we have this discovery that's not in

the dark. We don't do ambush. So, that's the main thing I guess, or the main points I would say in all of that. You know you can't believe how even highly perfumed experts are going to make silly screw-ups. They'll be a typo on their final presentation stuff for the jury. And you just need to look and double check it, even though they say they triple checked it, because there will be one there. And, you know, you're going to look kind of silly when the other side finds it. They found it in my case on my expert; I didn't like that. Great news: I found two typos in the other guy's expert, so and, you know, acted like it was not big deal, because, hey, everybody makes mistakes. It's a very, very detailed process.

JUDGE BONAPFEL: What if the company is a publicly traded company? Can you talk, maybe need to truncate a little bit—

KIT WEITNAUER: That's the main point of the Campbell Soup case and the Meridian case that are in the materials. Both have really good discussions of, not a short cut really, but what the courts have said. Look. If you got a public company, the public markets are supposedly the most efficient markets in the world, and that's where you find your value. So, what's that going to mean for nearly every public case is, cause everybody has some market cap until they file, and sometimes after they file, and even at confirmation when they're canceling the equity that seems to have a market cap, you're not going to be insolvent.

Now, these cases do allow for the fact that maybe the public markets were not well informed. But you're going to have to have a pretty strong case about that, if people have made the appropriate disclosure. That's another version of hindsight. The markets day-by-day said this thing was worth money. And then what, nine months later it's in bankruptcy and it's liquidated. Can we take that into account? You got to have some pretty strong evidence if the public has been well informed.

JUDGE BONAPFEL: The Meridian case, which is part of your materials, has limited precedential value in my judgment because it's so long, but, uh, if you are thinking about employing an expert, particularly in this area, that is a very good opinion to go look at just from the standpoint of advocacy and of your expert witness understanding how a trial judge valuates expert testimony. So, I recommend that case to you for that purpose.

Our next topic is spoliation. I have not had a spoliation issue come before me, but it's popping up in cases in the legal literature that I noticed about it.

Kit, what is spoliation and why do parties in bankruptcy cases, especially a trustee or a debtor in possession, have to worry about it?

KIT WEITNAUER: Well, we all know what happens when a refrigerator gets turned off for a long time. It's the same principle. No, actually, it's—in a good ole fashion case—it had to do with somebody going through the documents in response to a discovery request and saying, "Man, this is a hot document. I think I'll shred it." That's bad. That's spoliation. That sort of thing gets people sanctioned and, hopefully, they out to get thrown out of being able to practice law. But it's gotten to be a much broader kind of issue with respect to all this electronic data people have today. And I never had to really deal with the kind of large enterprise-wide discovery efforts involving electronic data. As you probably all know, cases lately have been trying to deal with this better. The rules have been amended to deal with this. And if you haven't dealt with it before, read Kmart. It will make your eyes roll back into your head about how many places data can be found and how hard it is to keep track of it. And how the processes of the IT department that fronts us when Judge Bonapfel leaves the firm to take the bench, well, his computer goes to the room the IT guys have, and two weeks later, boom, everything is wiped out on that computer, unless there's been a thing in the database that says, "This fellow was involved litigation." Then it goes to another place and then it's kept under seal in case it's ever needed. Then your IT programs will automatically delete these things but not these and a flick of the switch, they can change it. It's really amazing. I mean we all probably get a sense of how many places our data is, but what the Kmart case talks about is how a debtor, with all the claims and likely objection to claims, at somewhere along the way may have to do something about that. And they found in this case that it wasn't any sort of intentional destruction of data. But they really hadn't done a good job of preserving it, and the people who were complaining got some attorneys' fees. Ultimate judgment was reserved for the trial of the case. It turned out some stuff might have been intentionally destroyed. So that's the basic idea, and you really get into a lot of compliance issues. The new rules talk about how to come up with a plan for this electronic discovery, but you need to get a litigation hold out there when you know you have a dispute. It's very complicated when you have a debtor that might have a dispute on every claim.

JUDGE BONAPFEL: Now, what's a litigation hold?

KIT WEITNAUER: Basically it's a notice the general counsel of the company might get out, or the outside counsel might get out, to really—everybody in the organization and probably people who have documents under the control of the organization, like an outside accounting firm, saying, "Look, there's been litigation about X. You need to be sure you don't delete your emails, blah, blah, blah, and we'll be in touch with you to get copies of the things we need when the time comes."

JUDGE BONAPFEL: Is that something that counsel for the debtor in possession has to add to the list of things to check on before filing the case?

KIT WEITNAUER: I think you have to add to the list, I think given the cost of it, in a lot of places. You might say, "We really don't expect a lot of fusses and fighting, so let's don't go crazy about this." But if you don't think about it, I think you're in trouble, so, if you can afford it, you ought to try to preserve it. You really should. You're going to get in trouble if you don't. And I know it's' going to be a terrible clash with what the state has, especially on a liquidation case, but you got to deal with it.

JUDGE BONAPFEL: Okay. Creditors' committees don't start with any information, so they don't have a spoliation problem, but they need to get information from the debtor about assets, liabilities, business prospects, and so forth. Much of that may be confidential and the debtor may resist turning it over in the absence of confidentiality protections. Well that conflicts with the new set of duties that BAPCPA imposes on creditors' committees under Section 1102 (b)(3). First, under that new statute, the committee must provide access to information to creditors' with claims of the type represented and who are not on the committee. Second, the committee must solicit and receive comments from such creditors. How are committees resolving this problem of keeping information confidential, while providing access to creditors, and how does a committee fulfill its duty of soliciting and receiving comments? I keep starting with Kit, but Harris, jump in anytime.

HARRIS WINSBERG: Most of the protocols that you see basically say, "Go to a web site," is what my experience has seen. The creditor's committee counsel files a motion of protocol, and it's really just making documents, really an ECF available on the web site you can go to. They really haven't added a whole lot of new and additional information.

I have yet to see in any case where a creditor is really pressed to see information that's really commercial sensitive to the debtor such as

projections, where you're going with the case. I have yet to see them press to get that from a creditor. It's really just going to the website of publicly available documents.

KIT WEITNAUER: You know, we've included an example of a motion our firm filed up in New York in a case, and I think Harris is exactly right. We had a couple of other things in there that, at least in theory, could help the communication process. There was an email address where folks could basically automatically generate to the committee with questions and responses would come from the committee chair or counsel to the committee. And our motion basically says that we're not trying to preclude anybody, bringing a motion for any specific information, where the courts could ask whether or not it really collided with our duty to be the keeper of confidential information as we try to negotiate a plan. But it's a safe harbor, really for the committee so that they're, you know, making things convenient for folks who have a passing interest. But if there's a real important question about that information, I thinks it's probably going to get deferred to a motion for the court if can't enter into a confidentiality agreement.

JUDGE BONAPFEL: This protocol is something that is approved by the court?

KIT WEITNAUER: It is. Revco, I think, is one of the first cases that did it. And it's what everybody predicted wants—the amendments came into place, and it seems to be very common.

JUDGE BONAPFEL: Anything else?

HARRIS WINSBERG: On credit community disclosure; no.

JUDGE BONAPFEL: Okay. Our last segment that we're going to talk about are suits brought by a trustee or an estate representative against third parties, typically, the debtors' accountants or attorneys or other professionals, arising out of their conduct in connection with the debtor's financial demise, in particularly where their fraudulent conduct might have been involved. Creditors are looking at, in such cases, are frequently looking at getting very little, if any, recovery because of the nature of the secured lending on the debtor or the claims may be so large and the assets are relatively small that they're looking for other deep pockets to get some recovery for their claims out of. Harris, we're finally to you. What are the types of claims that a trustee or other estate representative may seek to bring and what defenses does she face?

HARRIS WINSBERG: Sure. Oftentimes in the large corporate fraud cases, as Judge Bonapfel said, people start looking for deep pockets. Two of the likely candidates that you see in the cases are the debtors' pre-bankruptcy accountants, particularly if it was a publicly traded company, they did an audit, or the debtors' pre-bankruptcy counsel that documented some deals that people may argue had no economic substance. The trustee will bring those claims. These types of claims are more important now with some recent Supreme Court authority that we put in the materials, making it more difficult for individual creditors to bring these types of claims. And the common claims you'll see are really garden variety. They go from accounting to legal malpractice to aiding and abetting a breach of fiduciary duty by the debtor's pre-bankruptcy management or aiding and abetting a fraud of the pre-bankruptcy management. And as Kit talked about earlier, sometimes there's fraudulent conveyance claims actually against the accounting firms and the law firms.

The aiding claims, which we focused on in the materials, the aiding claims you have to look to state law. And we talked about in the materials, really New York law, New York State Law is the best developed in the area. And outside of New York Law, a lot of jurisdictions it's questionable whether some of these claims are really recognized or not. When you bring an aiding claim, you're really extending the fiduciary relationship beyond what normally is expected. And so a lot of courts struggle with whether it's recognized. But under New York law, it is recognized and it's well developed. And the elements of those types of claims, the aiding claims, are really, there's really four elements of the claims you have to prove: You have to prove, obviously, a primary breach by the debtor's management or fraud by the debtor's management; the second problem you got to show that the defendant, the debtor's professionals, that they knew of the actual breach or fraud, constructive knowledge is not enough in this circumstance; three, you got to show substantial assistance that the debtor's professionals assisted the debtor in committing the breach or the fraud. And typically the way they do that there are some cases where if the outside law firm helps document a deal that really has no economic substance, but is used to inflate earnings to the public, some courts will say, "Well, yeah, that's substantial assistance," or, with an accounting firm, if they run their audit, and they run across an accounting issue where they don't disclose it properly in a footnote or they cave to management not wanting to give a better disclosure, they can bring an aiding claim there of substantial assistance. And then four, the damages. And damages are really the dovetail back into substantial assistance. You got to show causation that

the acts of these professionals proximately caused the damage to the estate. So those are the four elements that you have to look at. It's very difficult to plead properly. A lot of courts will, if you don't—you can't do most of these claims on information in a couple of weeks. You got to allege specific facts. They are very difficult to actually prove, but you got to show actual knowledge. And it's not access to the books and records. It's you knew and it's in your work papers, if you're the accounting firm, that you knew about it. Or it's in emails in the law firm so the trustee gets away privileged and the lawyers get—the trustees gets to see all those emails that the corporate lawyers did and they can show that the lawyers knew the documentation they were submitting had no economic substance.

But assuming the trustee can properly plead those types of claims, then they can overcome the substantial hurdles. There really is one primary defense, which has gotten a lot of discussion in jurisprudence in the courts and it will lump it together and just call it imperi delicto, which means an equal fault. And essentially that doctrine says that if the pre-bankruptcy management was at equal fault with the professionals, then you can't, the trustee can't recover against the professionals. And the reason why that doctrine is available is 541 of the bankruptcy says that the trustee can step into those cause of actions that become property of the estate, but they're subject to whatever defenses that would be available under state law. You compare that with fraudulent conveyance action under 544 and 548, you know there is no such equitable defense.

You have to look to state law. State law will determine whether imperi delicto is a viable defense, and you have to think about it. And I've looked at cases and they're essentially a mess. You can find a case; basically, saying about whatever you want it to say, but really there's five questions you have to ask. The first question you want to ask is the trustee's claim, is it a claim that belongs to the debtor or does it belong to the individual creditors. If the claim belongs to the individual creditors and not the debtor, then the trustee doesn't have standing to pursue it. And that's what the second circuit court in the Wagner decision discussed. They really discussed the concept of standing. That some of these claims are not the property of the estate; they're really individual creditor's claims. So that's the first question you have to ask is whose claim is it? The second question you have to ask yourself is if you got the standing, can the management's bad acts be imputed to the trustee? And that really is the pure imperi delicto defense, which is an affirmative defense. And again, you look to state law. The courts are split. Some courts actually

look at the equitable considerations and say, "I'm not going to impute on the trustee, because the trustee is not the pre-bankruptcy management. That's unfair. It hurts the estate." But most of the circuit courts say no you take to subject 541 of the code, that's including the 11th circuit decision in Edwards, and so imperi delicto can impute to the trustee and bar the trustee from collecting against the professionals, if the pre-bankruptcy management was at equal fault.

But that doesn't end the inquiry. The third question you have to ask is did the debtor benefit from the management's pre-bankruptcy management's wrong doing? And if the answer is no, the debtor did not benefit from the fraud or the breach, something called the adverse interest exception applies. And there can be no imputation on the trustee except as to question 4. In this problem, the only thing I'd keep in mind is the court's say it really only has to be a scintilla of benefit. So in a lot of cases, if the debtor's—professionals help the debtor inflate it's revenue so it can do a stock offering and the debtor went out and printed more stock, raised more funds, even though it was a fraud, it benefited the debtor, so it's an easy prong to look at. The fourth question –

KIT WEITNAUER: And amazingly, in deciding benefit, the courts don't say, and at the same time you became subject to lawsuits, they're going to ruin your company. They act like that doesn't matter. Do they still find the benefit?

HARRIS WINSBERG: They don't look at that and they don't consider the contingent liability you just picked up, and securities lawsuits, and other claims can be brought against you. True.

The fourth question, if you're not lost yet, and I had to write it down five times, is even if the debtor got no benefit, did the wrong doers, the pre-bankruptcy wrong doers, control the debtor? And if the answer is yes, there was nobody else around that ran the show, essentially one shareholder, closely held board, something called the sole actor exception applies. It's actually coined an exception to the exception, the exception being adverse interest. If the sole actor exception applies, then the trustee's barred. And you get into questions of whether there were independent board members. Were they truly independent? Was there somebody in management that wasn't a part of the fraud? So, you have to answer that question.

The final question, which dovetails, they have to answer to make it more confusing is some court's say, if there exists an "innocent decision maker," was present and that someone was not involved in the fraud, and had the power

to stop it. And that's where the litigation fight is. So what? So what if there was independent board members that approved these transactions. If the board was controlled by the wrong doers, they didn't have the power to stop it. And so you get into litigation about what exactly that means. But if there is an innocent decision maker, that would operate as an exception to the sole actor principle or some courts construe it as the just precluding the application of the sole actor exception to the exception. Even more confusing, some courts say that the innocent decision making doctrine even exists and other courts say it does exist. So, if you're confused you're not the only one. I'm confused and the courts are too. And the reason why the courts are confused is you can print off a stack of 80 cases and line them up you would not able to reconcile them on all the detail, but essentially those are the five questions you have to ask to see whether the trustee's claims would be barred.

The recent trend, and why all these complaints get filed, even when they're well pled, is the law firms and the county professional file large 12 (b)(6)motions to dismiss these claims and the recent trend that I've seen in the courts is to deny those motions because of the factual issues regarding adverse interest exceptions, sole actor, exception to the exception, decision maker, so even when a complaint is not, not exactly forceful in a lot of ways, the court is allowing, the recent trend is to allow these cases to go beyond the pleading stage, which you get into then issues of fact discovery, which can be very expensive and sometimes embarrassing for the accounting firms and law firms. You have to open up their work papers, their emails for the public to see and they get press in the big cases about what they find. And I did, if people are interested, print off a recent decision out of the Southern District in New York, Food Management Group case, which is a good discussion of the kind of steps you look at in the analysis of imperi delicto. In that case, you knew the law firm was in trouble, judge, when the bankruptcy court started off with this case raises important issues concerning the integrity of the bankruptcy process. You knew that the law firm wasn't going to do well by Page 60 of the opinion. But it's a—

JUDGE BONAPFEL: Another decision of limited precedential value.

HARRIS WINBERG: But it is a good example of when a professional, a law firm and, in this case, it was a law firm representing actually the debtor in possession can be held liable for the types of aiding claims, and in that case it was their alleged disclosure or nondisclosure of one of the qualified bidders in an auction that turned out to be wrong. And but it's a recent trend. You're

going to see more of this litigation as the economy, if the economy keeps a slide, litigation goes up but I think you'll see more trustee claims in the areas evolving. Whether these claims exist and how you prove them up, and on the contrary side of how imperi delicto operates as a defense is still evolving.

KIT WEITNAUER: Well that last case reminds you of bedrock principle as debtor's counsel, disclose, disclose, disclose. And the minute you think, "God, I don't want anybody to know about this." Ah, I better talk about that one. Your gut tells you.

JUDGE BONAPFEL: If there are potential claims in a case against the accountants and the lawyers and you're filing a Chapter 11 case, and your buddy has referred that to you because they represented the debtor for years, but now they can't because they're conflicted, do you have to write the managing partner of that law firm and say we're representing the debtor and by the way put a litigation hold on everything you did for him?

HARRIS WINSBERG: That's an interesting question. It depends when you knew the claim, when you find the claim exists and you got a basis for the claim, and when that investigation occurs, and certainly at that point in time—in the typical cases, and when I've seen them these are legal malpractice cases, a lot of this is—it's really, it's not in the public forum. If they send a demand letter over, sometimes they may even send the complaint to the law firm over, because once it's get aired out, these types of claims, it reveals a lot, can reveal a lot of dirty laundry like this Food Management case. The trustee can waive privilege. That's when you really can find some bad emails, particularly, corporate lawyers in general don't view, and litigators are pretty good with their emails. Litigators realize that email is just like a written letter and the general rule is you wouldn't want to put anything in writing that you wouldn't want your mom to see.

JUDGE BONAPFEL: Or worse, a jury.

HARRIS WINSBERG: A jury to see. But corporate lawyers write incredible things and I've had a couple of large cases I've been involved with that corporate lawyers are writing things, whether kidding or not, it doesn't come across that way and they're damaging. They're damaging emails. But I think, to answer your question, judge, I think you—if you put the letter into the law firm you need to preserve your files when you recognize that a claim existed against that law firm. I think that's when you do it.

JUDGE BONAPFEL: I want to go back to—first are there any questions? Anybody have any questions? We got a few minutes left. I wonder, we talked about this a little bit, getting back to the expert question when, let me see if I can find exactly what, oh, the prior connection to the case situation with an expert. In some instances debtors or committees will hire a financial consultant or an accounting firm or restructuring advisor and, of course, instead of just one person to be the advisor you get a whole—

KIT WEITNAUER: You get a team.

JUDGE BONAPFEL:—You get a team. Are they so connected to the case that when the occasion arises at a later point are they qualified to give expert testimony?

KIT WEITNAUER: I would, I think you open yourself up to some risk on the bias point, especially, as often the case, the restructuring advisor has a success fee associated with their engagement and so if, to get to the finish line on a confirmed plan, and you're going to have a fight over valuation. If someone from that firm is your expert witness on—hey, the company is solvent or the best interest test is not measured, all that stuff to get you pass the hurdle, well, they got a success fee at risk and that's the problem. So, I would suggest in that case they ought to find somebody else. And even if had a separate litigation matter; say over fraudulent transfer, I think I would try to find somebody else too. And normally it's a soup to nuts kind of engagement where they're willing to do everything, but I think the litigator in me says I would like to find a separate expert for those kinds of issues.

HARRIS WINSBERG: The issue there, from my experience, the federal rules allow you to have someone testify as a fact expert, and Kit is absolute right that by—Daubert still applies, but the rules allow that and in normal situations, judge, and I'm sure you've seen it on the bench, if someone comes in with a finance and they come in day one, they seek to retain their financial advisor, either under 330 or 328, that advisor's fee probably concludes the success fee for the closing of (inaudible word). That's common. And then who are you going to put up to prove that your (inaudible word) meets 364. You put up the financial advisor. He talks about I went out and I talked to the 30 banks that are in this market, and I shopped it. Well, he's giving fact testimony. He's giving what is in his personal knowledge. But then he goes on to say and I know this market and I do DIP loans all the time and this DIP loan is fair and reasonable and within market and is in the interest of this data to go forward. So he's giving expert testimony. And of course he has this success fee and of

course that's disclosed; it's in his engagement letter and there's a motion filed with an affidavit. And I've done that. I've been in cases where we've done that. I've done that and our firm has done that. And I am surprise, and you got me thinking about, we talked about this yesterday, I'm surprised more people haven't come in and challenged that, that that person can give that, because there is a success fee. And I don't know if you've ever questioned the bias of a financial advisor in that kind of a situation.

JUDGE BONAPFEL: Well we don't get any of that in Atlanta, they're all in New York and Delaware.

KIT WEITNAUER: I haven't recalled seeing a success fee based just on getting a DIP financing. That, I think, will be a real problem, and if you have that, you raise a good question. But if it's on conclusion of a successful final reorganization or 363 sale, I wouldn't be so troubled that, in a buyer's (inaudible word), that mix of factual evidence and a little flavor of this is the market and this fine just to get the DIP financing closed. That doesn't make me as anxious. And it's not always the case that you have some huge fight over the DIP financing, except maybe around the edges, because everybody can see you got to have it or it's down the tubes.

JUDGE BONAPFEL: If you use what I'll call a retained or an already retained expert in that circumstance, and you get into a discovery battle, does that open up other things that they may have gotten—other communications they may have gotten?

KIT WEITNAUER: Assuming there's no success fee, what the expert has to disclose in the report is his or her conclusions and the things that were considered in coming to those conclusions. Well, does that include the things you cited weren't relevant? So, I think, it's fairly broad amount of stuff, at least in theory, but if you've got a team off doing, fixing the business, that same firm, and then you got this expert who just came in to do valuation, and he never pored over all that data, I don't think that should be something that matters. And even if when you got a firm that helps you in expert testimony, it's not uncommon to have a testifying expert and then his team of consulting experts. They're not going to be deposed. You're having some, maybe a fuller and frank discussion with them about the pros and cons of the case. They think about it. They talk to the testifying expert. And somehow there's some purity to what he comes to the stand with. And I think that's all kind of a weird dance, but people do it. They tend to have a consulting side and a testifying side.

HARRIS WINSBERG: And, one of the points, that you have to look to see who's—you have to look at the engagement letter, because the law that if a law firm goes out and hires a financial advisor or an expert to give—to help them render legal advice to a client, that's really work product, that's consulting expert. If the company's out hiring the financial advisor and the lawyer really isn't participating in that, then, I think, the files are open, they're fair game; they're discoverable.

KIT WEITNAUER: Well, I haven't had to research that, but I have heard that if it's otherwise discoverable, just the fact that the lawyers hire them is not going to change it. So, you're probably right that if the company hires, you're not bringing yourself much good, but I don't think you're going to get any insulation just by the lawyer hiring them.

HARRIS WINSBERG: No, no. And once you turn the switch, once you say to that consulting expert, you know, testifying expert, then everything that's in their files is potentially discoverable and frankly as a practical matter, when we worked with experts, we just presumed that everything we're doing would one day be made open. And a lot of people get real concerned about drafts of expert reports and my own personal view when we get these kinds of issues is I'd rather have a nice work file, that this thing was thought out, rather than have someone try to work extra hard not to create a paper trail. I'd rather them show their work papers, that it was well considered, they considered all the issues, rather than someone worrying more about the discovery rules than giving their opinion.

JUDGE BONAPFEL: Anything else?

KIT WEITNAUER: No, no, no.

JUDGE BONAPFEL: Any questions from anybody?

KIT WEITNAUER: We've put them to sleep.

JUDGE BONAPFEL: We put them to sleep. I forgot to point out when Kit was talking about valuation being based on predictions that we should all bear in mind what Yogi Berra said, which was, "Predictions are hard, especially when they're about the future." So, we will, with that, unless that prompts a further question or tomato, we will take a break until 11:30. Thank ya'll very much and thank our panelists.